No. 90-1890

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1990

DONALD E. CLARK

Petitioner,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., and WENDELL C. HOOVER

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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Petition for Writ of Certiorari

DAVID KENT HIGGINS
ROBINSON & MCELWEE
P.O. Box 1791
Charleston, WV 25326
(304) 344-5800
Counsel of Record for Petitioner

QUESTIONS PRESENTED

(1) DOES RESCISSION OF RULE 15C2-2 BY THE SEC INVALIDATE AN AGREEMENT BETWEEN A STOCKBROKER AND HIS CUSTOMER WHICH EXPRESSLY PROVIDES THAT THE CUSTOMER'S FEDERAL SECURITIES LAW CLAIMS MAY BE LITIGATED RATHER THAN ARBITRATED?

(2) FIVE CIRCUITS HAVE HELD THAT THE CUSTOMER'S CONTRACT RIGHT TO LITIGATE SECURITIES CLAIMS IS NOT AFFECTED BY RESCISSION OF THE RULE. SHOULD A FOURTH CIRCUIT DECISION TO THE CONTRARY NULLIFYING THE CUSTOMER'S CONTRACT RIGHT TO LITIGATE BE PERMITTED TO STAND?

LIST OF PARTIES BELOW

The Appellee in the Fourth Circuit Court of Appeals (Petitioner herein) was Donald E. Clark. Appellants in that Court (Respondents herein) were Merrill Lynch, Pierce, Fenner & Smith, Inc. and Wendell C. Hoover. There were no other parties before the Fourth Circuit Court of Appeals in this matter.

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OPINION BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit (Record No. 90-2039) whose judgment is herein sought to be reviewed, was decided and filed on January 31, 1991. Said opinion has been published at 924 F.2d 550 (4th Cir. 1991). A copy of the opinion is reprinted in the Appendix hereto, *infra*, page 1a. A Petition for Rehearing was denied on March 22, 1991. A copy of the order denying the Petition is reprinted in the Appendix hereto, *infra*, page 13a. The Memorandum Opinion and Order of the trial court entered February 9, 1988 and the Memorandum Opinion and Order of the trial court entered May 27, 1988 (both of which rulings relate to the decision of the trial court that the federal securities law claims may be litigated and need not be arbitrated) are reprinted in the Appendix hereto, *infra*, pages 14a and 24a.

STATEMENT OF JURISDICTION

The judgment of the Fourth Circuit Court of Appeals was entered on January 31, 1991. A timely Petition for Rehearing was denied on March 22, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

No statutes are directly involved in this case. A Securities Exchange Commission regulation is involved. That regulation is Chapter II, Title 17 of the Code of Federal Regulations, Part 240—General Rules and Regulations, Securities Exchange Act of 1934, § 240.15c2-2 commonly referred to as Rule 15c2-2. (Appendix, *infra*, page 30a). In addition, Exchange Act Release No. 25034 dated October 15, 1987, which rescinded Rule 15c2-2 (Appendix, *infra*, page 31a), is involved in this case.

STATEMENT OF THE CASE

On August 7, 1986, Donald E. Clark ("Clark") instituted a civil action in the United States District Court for the Southern District of West Virginia against Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") and Wendell C. Hoover ("Hoover") seeking to recover monetary damages resulting from the mishandling of Clark's brokerage accounts by the defendants during 1985. The Complaint alleged that the defendants had violated Rule 10b-5 promulgated under Section 10b of the Securities Exchange Act of 1934 (Count I), the Racketeer Influenced and Corrupt Practices Act (Count II), West Virginia securities laws (Count III), and a broker's common law duty of ordinary care and fiduciary duty to its customer (Count IV). The Complaint also alleged a cause of action for breach of contract (Count V) and a cause of action for money due and owing (Count VI). Based upon the applicable 1985 customer agreements between the parties, the defendants moved for an order staying all further litigation and requesting that all of Clark's claims be sent to arbitration.

The District Court granted the defendants' motion to compel arbitration with regard to five of the six counts contained in the Complaint. At the same time, the District Court held that the federal securities law claims (Count I) should be litigated since the customer agreements expressly contained language which excluded federal securities law claims from the requirement that all other types of disputes were to be arbitrated. Those claims were tried before a jury. On September 1, 1989 the jury returned a verdict in favor of Clark and against both Hoover and Merrill Lynch in the amount of $1,683,170.00 plus interest.[1]

Respondents herein appealed to the United States Court of Appeals for the Fourth Circuit alleging, among other things, that the trial court had committed error in refusing to compel arbitration of the federal securities law claims. In its decision

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[1] By agreement of the parties, the arbitration proceedings are being stayed pending resolution of this litigation.

of January 31, 1991, the Fourth Circuit held that the federal securities law claims should have been sent to arbitration by the District Court for reasons stated in the opinion. Accordingly, the Fourth Circuit vacated the jury award and remanded the case to the trial court.

Clark filed a timely Petition for Rehearing with Suggestion for Rehearing In Banc. In the Petition for Rehearing he argued that the decision of the Fourth Circuit was in direct conflict with the decisions of five other circuit courts that had considered the issue, a point which the Fourth Circuit failed to note in its January 31 opinion.

After a poll of the Court where three judges voted to rehear the case in banc, the Fourth Circuit by majority vote denied the rehearing in banc. The panel thereupon denied the Petition for Rehearing without further comment.

JURISDICTION OF THE DISTRICT COURT

Subject matter jurisdiction in this case was conferred upon the United States District Court by 28 U.S.C. § 1332, 28 U.S.C. § 1331, the principle of pendent jurisdiction and 18 U.S.C. § 1964(c).

REASONS FOR GRANTING WRIT

I. THE DECISION OF THE COURT OF APPEALS FOR THE FOURTH CIRCUIT IS IN DIRECT CONFLICT WITH THE DECISIONS OF THE FIVE OTHER CIRCUIT COURTS OF APPEALS THAT HAVE RULED ON THE SERIOUS ISSUE RAISED IN THIS CASE. THE ANOMALOUS RULING OF THE FOURTH CIRCUIT IS MISTAKEN AND SHOULD BE REVERSED.

The applicable customer agreements between Clark and Merrill Lynch were drafted by Merrill Lynch and state expressly that Clark is not required to arbitrate claims and disputes arising under the federal securities laws. Three of the

four customer agreements executed between Clark and Merrill Lynch in 1985 contain the following language:

> Except to the extent that controversies involving claims arising under the Federal Securities laws may be litigated ... any controversy between us ... shall be settled by arbitration.

The fourth agreement also signed in 1985 contains this language:

> Although you have signed a customer agreement form with MERRILL LYNCH that states you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the Federal Securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

This language plainly excludes claims arising under federal securities law from the scope of the arbitration agreement between the parties. Such language is generally referred to as "litigation language" or "exclusionary language."

The Fourth Circuit refused to enforce the "litigation language" contained in the customer agreements between Clark and Merrill Lynch. It held that the language constituted "mere notice" of a right to litigate established by a Securities and Exchange Commission ("SEC") rule that was in effect at the time the agreements were executed. The court apparently took the view that the language did not mean what it says. Thus, the court concluded that Clark's contractual right to litigate lapsed when the SEC unilaterally rescinded its rule in 1987.

The Fourth Circuit must have reviewed the decisions of five other circuit courts that have considered this issue. Inexplicably, however, its opinion failed to mention that those courts have uniformly held that "litigation language" is *not* "mere notice" of a right to litigate but rather constitutes a substantive and fully enforceable term of the contract between the parties. *See Ballay v. Legg Mason Wood Walker, Inc.*, 878

F.2d 729 (3d Cir. 1989); *Catholic Diocese of Brownsville, Texas v. A. G. Edwards & Sons, Inc.*, 919 F.2d 1054 (5th Cir. 1990); *Giles v. Blunt, Ellis & Loewi, Inc.*, 845 F.2d 131 (7th Cir. 1988); *Gooding v. Shearson Lehman Bros., Inc.*, 878 F.2d 281 (9th Cir. 1989); *Blue Gray Corps. I & II v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 921 F.2d 267 (11th Cir. 1991).

In a decision that was reviewed by this Court on grounds unrelated to the issue at hand, the Second Circuit did state in a footnote its view that "litigation language" constituted only a notice unenforceable as a contract provision between the parties. *Bird v. Shearson Lehman/American Express, Inc.*, 871 F.2d 292, 295 N.5 (2d Cir. 1989), *vacated* ____ U.S. ____, 110 S.Ct. 225, 107 L.Ed.2d 177 (1989). However, the Second Circuit did not state its reasons for the footnoted comment. Its decision was subsequently vacated by this Court on other grounds.

In the Petition for Rehearing, Clark brought to the attention of the Fourth Circuit that its decision was in direct conflict with the rulings of the five other circuits that have resolved the question. Nevertheless, without explanation the Fourth Circuit refused to rehear the case. Clark is compelled therefore to seek relief from this Court.

In its decision upholding the customer's right to litigate, the Third Circuit correctly observed that the matter at hand "presents a question of considerable current interest in the marketplace." *Ballay*, 878 F.2d at 730. The integrity of federal law with respect to brokerage and other financial services agreements makes it imperative that this Court resolve the serious conflict between the Fourth Circuit and five other circuits. The Fourth Circuit should not be permitted to maintain a rule that directly contradicts the law as unanimously interpreted by the other circuits. Customers of brokerage houses should not have materially different rights depending only upon the circuit in which they reside.

II. THE REASONING OF THE FIVE CIRCUITS THAT HAVE HELD THAT THE "LITIGATION LANGUAGE" CONSTITUTES AN ENFORCEABLE CONTRACT TERM IS VASTLY SUPERIOR TO THE REASONING OF THE FOURTH CIRCUIT.

Five circuits uphold the customer's right to litigate federal securities law claims under "litigation language" clauses inserted in customer agreements prior to the rescission of Rule 15c2-2. The Fourth Circuit, however, adopts a contrary rationale which has been specifically rejected by every other circuit which has analyzed the issue.

In its decision, the Fourth Circuit began by observing that the "litigation language" used by Merrill Lynch in its 1985 customer agreements with Clark was inserted as a response to adoption by the SEC of Rule 15c2-2 in 1983. Under that rule, the SEC announced that it would be a fraudulent, manipulative or deceptive act or practice for a broker to enter into an agreement with a public customer which purported to bind the customer to the arbitration of future disputes between the brokerage house and the customer which arose under the federal securities laws. After this Court's decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), the SEC decided to rescind its Rule. *Exchange Act Release No. 25034* (October 15, 1987). (Appendix, *infra*, page 31a).

Unlike all other circuits which have fully addressed this issue, the Fourth Circuit somehow has erroneously concluded that recission of Rule 15c2-2 by the SEC also served to repeal and void a contract right to litigate securities claims agreed to by the parties. It translates the "litigation language" expressly agreed upon into nothing more than "mere notice" of a right which will continue only if the SEC does not decide to rescind its rule.

The other circuits, however, have repeatedly refused to void or re-write the contract between the parties merely because the SEC rescinded Rule 15c2-2. Those circuits have all held that

rescission of the rule had no effect whatsoever on the plain language of the customer agreement. They have taken the view that a broker's rationale for including the "litigation language" in the contract is irrelevant to the status of that language as a substantive, enforceable contractual provision. Several circuits have taken note of the fact that, as here, "[t]here is no indication on the surface of the contract that the parties intended this language to serve merely a notice function. Indeed, the context in which the language is found suggests the opposite." *Catholic Diocese,* 919 F.2d at 1057.

The rationale of the five other circuits is expressed well in the following language of the Third Circuit:

> ... [W]e conclude that the unequivocal exclusionary language in the plaintiffs' arbitration agreements creates a contractual right to litigate plaintiffs' Securities Act claims. The language admits of no justification for looking beyond it to the regulatory history surrounding its conclusion. In any event, even if we were to look at the regulatory background we see no reason in it for rejecting customers' reasonable expectations. A customer reading the exclusionary language would not be expected to be aware of the regulatory background or to understand that the language may become meaningless with the winds of change in the law. Legg Mason, [the defendant brokerage firm] if it truly did not mean to be bound by the contractual language it drafted, should have challenged Rule 15c2-2 or re-executed the arbitration agreements in accordance with its intent after recission of the Rule. It cannot now win relief from the specific language of its own contract simply because it claims not to have meant what it said.

Ballay, 878 F.2d at 734.

Nothing in the agreement between Clark and Merrill Lynch indicates that Merrill Lynch did not intend to be bound by its own language. No indication is given, though it easily could have been, that this language was not to be interpreted as an enforceable term of the contract. No hint is given that the parties intended this language—which seems plainly to be an

enforceable contractual provision—to be interpreted as "mere notice" of a right derived solely from an SEC rule. Speaking of the virtually identical agreement between the parties in *Catholic Diocese,* the Fifth Circuit observed that the broker "might have drafted an explicit notice provision, or it might have drafted the exclusion so that it expired along with rule 15c2-2 and Wilko v. Swan, as other brokers did." 919 F.2d at 1057. Thus, in the words of the Fifth Circuit, the language in question "did more than give notice of the existing law: it incorporated that law, without exception or qualification, into the contract." *Id.*

III. ONLY ONE RULE OF LAW SHOULD APPLY ON THIS SUBJECT.

The Fourth Circuit stands in isolation against five other circuits on a matter of significant procedural importance. The issue of the enforceability of "litigation language" has arisen in at least six circuits and affects the rights of public customers of brokerage firms throughout America. It is likely to arise elsewhere. Without action by this Court, customers of Merrill Lynch and other brokerage houses having "litigation language" in their contracts will be allowed to litigate federal securities law claims in most jurisdictions but will be compelled to arbitrate those claims in the states comprising the Fourth Circuit and in other states if circuit courts that have not ruled on the issue decide to follow the Fourth Circuit. Such an imbalance can only be rectified by this Court. It is submitted that only one rule of law should prevail.

IV. THE FOURTH CIRCUIT MISAPPLIES ITS OWN PRECEDENTIAL AUTHORITY.

The Fourth Circuit relies upon its decision in *Jeske v. Brooks,* 875 F.2d 71 (4th Cir. 1989). In *Jeske,* the court held that the mere existence of Rule 15c2-2 as an administrative regulation promulgated by the SEC did not confer upon a public customer the substantive right to litigate federal securities law claims when the customer agreement with the brokerage firm clearly provided that all disputes would be

subject to binding arbitration. In other words, the contract provision which required arbitration of all disputes should prevail over the rule which required litigation of securities claims. In *Jeske* Rule 15c2-2 was held to be totally ineffective to modify the express agreement between the customer and his broker.

In the case at hand, however, the Fourth Circuit failed to consider the following question: If the presence of the rule did not affect the contract between the parties in *Jeske,* how can the recission of the rule modify the contract in this case? If the rule is ineffective for one purpose, it must be ruled ineffective for the other.

V. THE FOURTH CIRCUIT DECISION IS AN UNJUSTIFIED INTRUSION INTO THE RIGHT OF PRIVATE CONTRACT.

The Fourth Circuit decision, if permitted to stand, will invite citation as authority for the proposition that language in a contract should be ignored by the courts whenever the language in question was inserted in the contract in response to an administrative rule which was subsequently withdrawn. In this case, Merrill Lynch could have drafted its customer agreements with Clark in such a manner that Merrill Lynch's willingness to litigate federal securities law claims would be clearly conditioned upon the continued existence of the regulation. The agreements in this case contain no such condition. Nevertheless, the Fourth Circuit's decision permits Merrill Lynch to avoid its own contract language merely because Rule 15c2-2 was rescinded. Such a result is wholly inconsistent with a due regard for the integrity of private contracts.

CONCLUSION

The Fourth Circuit has rendered a decision which is in conflict with at least five other circuits. The decision by the Fourth Circuit should be reviewed by this Court. Without review by this Court, there will be a "split" in the circuits on an important issue of federal law.

Respectfully submitted,

DAVID KENT HIGGINS

Counsel of Record for Petitioner

E. GLENN ROBINSON
Robinson & McElwee
P.O. Box 1791
Charleston, WV 25326
Telephone: (304) 344-5800

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 90-2039

DONALD E. CLARK,
Plaintiff—Appellee,

versus

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED, a New Jersey corporation; WENDELL C. HOOVER
Defendants—Appellants.

Appeal from the United States District Court for the Southern District of West Virginia, at Huntington. Robert J. Staker, District Judge. (CA-86-879-3)

Argued: October 31, 1990 Decided: January 31, 1991

Before MURNAGHAN and NIEMEYER, Circuit Judges, and YOUNG, Senior United States District Judge for the District of Maryland, sitting by designation.

Vacated and remanded by published opinion. Judge Murnaghan wrote the opinion, in which Judge Niemeyer and Senior Judge Young joined.

ARGUED: Richard H. Sinkfield, ROGERS & HARDIN, Atlanta, Georgia, for Appellants. E. Glenn Robinson, ROBINSON & MCELWEE, Charleston, West Virginia, for Appellee. **ON BRIEF:** Paul W. Stivers, James W. Beverage, ROGERS & HARDIN, Atlanta, Georgia, for Appellants. David K. Higgins, ROBINSON & MCELWEE, Charleston, West Virginia, for Appellee.

MURNAGHAN, Circuit Judge:

Appellee Donald Clark is a successful businessman who, since 1981, had traded in securities markets through appellant Merrill Lynch, Pierce, Fenner & Smith and its employee-broker, appellant Wendell Hoover. In January of 1985, Clark decided he needed a new investment strategy to meet cash flow requirements and told Hoover that he was thinking of investing in municipal bonds. Hoover and Merrill Lynch options specialist Richard Gordon convinced Clark instead to produce income through a combination of premiums from covered options, dividends, interest, and gains from sales of stock, assuring Clark that such a strategy would meet Clark's monthly cash flow requirements.

The strategy did not perform as expected. By December of 1985, despite repeated assurances by Hoover and Gordon that his monthly income requirements were being met, Clark liquidated his positions and invested in municipal and corporate bonds.

Clark then brought suit in the United States District Court for the Southern District of West Virginia, Charleston Division, alleging state and federal securities fraud claims. The district court (Staker, J.) referred all of the claims to arbitration except the claim brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, thereunder. Merrill Lynch filed a motion to compel arbitration of that claim, and the motion was denied.

After a trial on the Section 10(b) claim, the jury returned a verdict in favor of Clark, awarding $1,683,170 in lost income, the increased cost of purchasing the bond portfolio, and prejudgment interest. Merrill Lynch and Hoover appeal, claiming that (1) the district court erred in refusing to compel arbitration of Clark's Section 10(b) claim; (2) Clark failed to prove actionable fraud or fraud in connection with the purchase or sale of a security under Section 10(b); (3) Clark failed to prove damages; (4) the damages awarded constituted a double recovery and were speculative; (5) the district court submitted erroneous jury instructions on scienter, damages, reliance, and defenses to fraud; and (6) the district court abused its discretion in denying Merrill Lynch's and Hoover's motion for a new

trial. The paramount question confronting us is whether the motion to compel arbitration of the Section 10(b) claim was improperly denied.

I.

Donald Clark lived in Buckhannon, West Virginia, from 1963 until 1983; he started his own company there in 1963. The company provided services to the oil and gas industry, and Clark sold it to NL Industries, Inc. ("NL") in April 1979. Clark received over $9 million on the sale, including 300,000 shares of NL stock valued at $20 per share.

In 1981, Clark opened a brokerage account with Smith Barney, Harris, Upham & Company. Hoover was his broker there, and when Hoover moved to Merrill Lynch shortly thereafter, Clark transferred his account. The account became known as the "02" account.

Hoover also introduced Clark to Richard Gordon, manager of Merrill Lynch's Managed Options Service in New York. Gordon specialized in options, specifically covered call writing. Clark opened a second account with Merrill Lynch in New York in February 1982 which Gordon managed and which became known as the "01" account.

The covered call writing continued through 1981, 1982, and 1983. During that time and into 1984, Clark's income fell by roughly $500,000, and he became pressed for income to pay his expenses. After examining his accounts' performance and concluding that the 02 account was not providing him with a sufficient return, Clark told Hoover in September 1984 to stop trading in options.

On January 16, 1985, Clark, Hoover, and Clark's accountant, Don Nestor, met in Buckhannon. Clark was considering investing in tax-free municipal bonds to produce the income that he felt he needed and told Hoover so. Hoover told Clark that he should consider another course, and recommended income production through a combination of premiums from covered options, dividends, interest, and gains from sales of stock. Hoover emphasized that he believed such a program could exceed the return on municipal bonds. After discussions with Hoover, and after a subsequent telephone conference call

with Hoover and Gordon in which Gordon said that he believed that Clark's needs could be met through the recommended strategy, Clark decided not to invest in municipal bonds and to follow Hoover's recommendation to restructure the portfolio.

Clark kept the 01 account in New York with Gordon and the 02 account in Huntington with Hoover and opened a new "03" account in Huntington with proceeds from the sale of his NL stock. Clark's income goals or objectives were $5,500 per month from the 01 account, $15,000 per month from the 02 account, and $25,000 per month from the 03 account, representing an annual return of approximately 12.7%.

As early as February or March 1985, the accounts were failing to meet their objectives. In April or May 1985, Clark spoke with Hoover several times about Clark's inability to conclude from his account statements that his investment objectives were being met. According to Hoover, Clark's objectives were being met and he so informed Clark although that fact was not reflected in the monthly account statements. To address Clark's concerns, Hoover recommended transferring the 02 and 03 accounts from Huntington to New York. The accounts were transferred in June 1985. Hoover continued to be in contact with Clark about his accounts, although investment decisions thereafter were made through Gordon in New York.

Clark, Nestor, Hoover and Gordon met on August 15, 1985, to review the accounts. At the meeting, Hoover again assured Clark that his accounts were performing as they should. By late October, however, Clark was again pointing out to Hoover and Gordon that he was unable to see where his accounts had earned more in income than he could see in his monthly statements, and arranged a meeting in New York with Gordon and with Nestor, accountant for Clark. Clark and Gordon compared summaries of the accounts at the October 31, 1985, meeting, and Clark, not satisfied with the amounts he had been receiving, stopped any new trading in the accounts. On November 21, 1985, he directed Gordon to close the accounts and liquidate the investments. By December 3, 1985, the liquidation was complete.

Clark brought the present action in August 1986, alleging that Merrill Lynch and Hoover had violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. He also alleged that Merrill Lynch and Hoover had violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1962 and 1964, and were liable under a number of state law claims. The district court referred all of the state law claims to arbitration[1] but did not act to refer with respect to the Section 10(b) and RICO claims.

Merrill Lynch and Hoover moved to compel arbitration of the federal claims; the motion was granted as to the RICO claim and denied as to the Section 10(b) claim. After trial, the jury returned a verdict in favor of Clark, awarding $1,683,170 in lost income, the increased cost of purchasing the bond portfolio, and prejudgment interest. Merrill Lynch and Hoover filed a timely notice of appeal.

II.

At the threshold we are confronted with two issues arising from a dispute between the parties as to whether they contractually agreed to submit any claim, including a Section 10(b) claim, to arbitration.

By memorandum opinion and order dated February 9, 1988, the district court ruled that Clark's federal securities law claim could be litigated and denied Merrill Lynch's motion to compel arbitration and to stay further court proceedings relating to that claim. A subsequent motion by Merrill Lynch for reconsideration was denied on May 27, 1988. Merrill Lynch now appeals the denial of the motion for reconsideration.

A. Effect of Waiving Interlocutory Appeal on Availability of Appeal from Final Judgment

While conceding that the denial of Merrill Lynch's motion was subject to interlocutory appeal under 28 U.S.C. § 1292(a)(1), Clark contends that this court now lacks jurisdiction to review the district court's ruling on the issue, simply because the time within which to bring the interlocutory appeal

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[1] The arbitration proceedings have been suspended pending the outcome of this appeal.

has long since expired and that, in failing to bring an interlocutory appeal, Merrill Lynch somehow waived its right to raise the issue on appeal after final judgment. To rule otherwise, continues Clark, would afford Merrill Lynch "a second bite at the apple." In support of his novel argument, Clark cites *Browder v. Director, Dept. of Corrections*, 434 U.S. 257 (1978); *Washington v. Bumgarner*, 882 F.2d 899 (4th Cir. 1989); and *Shah v. Hutto*, 722 F.2d 1167 (4th Cir. 1983) (*en banc*).

The argument is utterly without merit. *Shah* and the other cases Clark cites have nothing to do with the instant case; they involve tardy appeals from final orders and final judgments. Rather, 16 Wright, Miller, Cooper & Gressman, *Federal Practice and Procedure* § 3921 (1977) at 11, provides the proper authority:

> [A]lthough appeals are available under § 1292(a)(1) as a matter of right, failure to take an available appeal does not of itself waive the right to secure review, on appeal from final judgment, of matters that could have been appealed but were not.

See, e.g., Drayer v. Krasner, 572 F.2d 348, 353 (2d Cir.), *cert. denied*, 436 U.S. 948 (1978) ("failure to take an authorized appeal from an interlocutory order [staying the action pending arbitration] does not preclude raising the question on appeal from the final judgment"). Hence, we clearly have jurisdiction to consider an appeal from the final judgment of the district court's denial of Merrill Lynch's motion to compel arbitration.

B. Agreement to Litigate Federal Securities Law Claims

Turning to the question of an agreement to litigate federal securities claims, Merrill Lynch asserts that the language of the arbitration clauses in all of the brokerage agreements entered into with Clark require arbitration of all of Clark's claims. Thus, it continues, the district court erred in concluding that the contradictory language of one particular agreement was controlling and thus gave Clark the option of litigating his Section 10(b) claim.

Between 1981 and 1985, Clark signed numerous brokerage agreements containing three types of arbitration clauses. The first of those three clauses appears in all of the agreements executed prior to 1985—eight agreements in all—and provides

that "any controversy" between Clark and Merrill Lynch arising out of Clark's transactions with Merrill Lynch or out of the particular agreement itself shall be settled by arbitration.

The second arbitration clause, which appears in three other agreements signed in the first half of 1985, provides:

> Except to the extent that controversies involving claims arising under the Federal securities laws may be litigated . . . any controversy between us . . . shall be settled by arbitration.

The third type of arbitration clause, and the one to which the district court ultimately looked in finding a contractual agreement to litigate federal securities claims, appeared in a single Managed Options Agreement signed by the parties on June 24, 1985, and read as follows:

> Although you have signed a customer agreement form with MERRILL LYNCH that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

At the same time the Managed Options Agreement was executed, the parties executed two Standard Options Agreements containing the second type of arbitration clause discussed above.[2] The two Standard Options Agreements also contained a clause which purported to resolve conflicting language in other brokerage agreements. The clause reads:

> Any agreement by me with you, whether previously or hereafter made applicable to any account of mine with you, shall also apply to such option transactions except to the extent which it conflicts with this agreement. In the event of a conflict, this agreement shall control, and where there is no conflict, each provision of each agreement shall apply.

Merrill Lynch offers two arguments as to why the district court erred in concluding that the language of the Managed Options Agreement clause clearly and unambiguously shows that the parties intended and agreed that Clark did not have to submit

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[2] Thus constituting two of the three agreements signed in the first half of 1985 which contained the second type of clause at issue.

to arbitration—but rather could litigate—any claim arising out of alleged violations of federal securities laws.

First, Merrill Lynch contends that, because of the conflict resolution clauses in the Standard Options Agreements signed the same day as the Managed Options Agreement, the arbitration clauses in the Standard Options Agreements—the second type of clause discussed above—control and must be read in connection with the arbitration clause in the Managed Options Agreement. Thus, the argument continues, because the district court concluded that the language of the second type of clause requires arbitration of all claims, it erred in finding otherwise under the Managed Options Agreement clause.

Second, Merrill Lynch urges that the language of the arbitration clause contained in the Managed Options Agreement is simply a notice provision mandated by a now-rescinded SEC rule, Rule 15c2-2, 17 C.F.R. § 240.15c2-2 (1987),[3] and that as such does not create any substantive right to litigate rather than arbitrate a federal securities law claim. Therefore, claims Merrill Lynch, the inclusion of the Rule's language by Merrill Lynch in any agreement with Clark should not be held to have superseded and rendered void previous agreements to arbitrate all disputes.

As a preliminary proposition, we note that, in construing the arbitration clauses of contracts, there exists a presumption in favor of arbitrability. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *see also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (as with any other contract, parties' intentions control, but those intentions are generously construed as to issues of arbitrability). The question, so reframed, is whether the language of the agreements between Clark and Merrill Lynch is sufficient to overcome the presumption of arbitrability in favor of litigating the Section 10(b) claim.

We quickly dispose of Merrill Lynch's first contention by noting that the language of the arbitration clauses in the Standard Options Agreements was also added in response to the

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[3] Rule 15c2-2, entitled "Disclosure regarding recourse to the courts notwithstanding arbitration clauses in broker-dealer customer agreements," provided, in pertinent part:

notice provisions mandated by SEC Rule 15c2-2, an observation with which both the district court and Merrill Lynch agree. *See Clark v. Merrill Lynch, Pierce, Fenner & Smith*, CA-86-879-3 (S.D.W. Va. Feb. 9, 1988) (order granting in part and denying in part the defendant's motion to compel arbitration and stay proceedings) at 6; Brief of Appellants at 24, n.9. Thus, the arbitration clauses in the Standard Options Agreements and the Managed Options Agreement, all executed together on June 24, 1985, are not in conflict at all, rendering immaterial the question of which arbitration clause controls.

As noted earlier, however, the district court interpreted the language of the arbitration clauses in the Managed Options Agreement (the result of voluntary action) and the Standard Options Agreement (included only because of Securities and Exchange Commission mandate) differently. The court found that the language of the arbitration clauses in the Standard Options Agreements "to be advice or notice to the customer that the courts have held that claims involving the securities laws are not subject to binding arbitration agreements (not an expression by Merrill Lynch of willingness to litigate)," an obvious reference to Rule 15c2-2. But in construing the arbitration clause contained in the Managed Options Agreement, the

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(a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

(b) Notwithstanding paragraph (a) of this section, until December 31, 1984 a broker or dealer may use existing supplies of customer agreement forms if all such agreements entered into with public customers after December 28, 1983 are accompanied by the separate written disclosure:

> Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the Federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

court found that, because Rule 15c2-2 required the specific notice provision contained in the Rule be included in brokerage agreements only until December 31, 1984, the language of the clause in the Managed Options Agreement, entered into by Clark and Merrill Lynch on June 24, 1985 (*i.e.*, well after December 31, 1984), had to be construed to have become, chameleon-like, a voluntary agreement not to require arbitration. In so construing the clause language, the court concluded that the parties had agreed to litigate the Section 10(b) claim and denied Merrill Lynch's motion to compel arbitration. The only remaining question, then, is which of the district court's interpretations of two similar clauses contained in three documents executed on the same day—June 24, 1985—is correct.

To answer that question, we need look no further than Judge Murray's well-reasoned opinion in *Tauber v. Prudential-Bache Securities, Inc.* [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,226 (D. Md. 1990). In *Tauber*, the district court was confronted with facts virtually indistinguishable from the instant case in ruling on the defendant broker's motion to compel arbitration. There the plaintiff had entered into a series of brokerage agreements from 1984 through 1986. The agreements entered into in 1984, like all of agreements for Clark's 01 account and most of the agreements for his 02 account, contained arbitration clauses whereby the parties agreed to submit *all* claims to arbitration. The agreements entered into in 1985 and 1986 contained arbitration clauses containing language very similar to that contained in Clark's Standard Options Agreements signed on June 24, 1985. The *Tauber* court also noted that it had been the defendant's practice during 1984 to provide clients with the same notice contained in Clark's Managed Options Agreement.

Like Clark, the plaintiff in *Tauber* argued that the litigation language in the 1985 and 1986 agreements should be construed not as mere notice but as creating a substantive right to litigate federal securities law claims. The *Tauber* court began its analysis by carefully examining (a) the Supreme Court case law shaping Rule 15c2-2 from cradle to grave; *see Wilko v. Swan*, 346 U.S. 427 (1953); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220 (1987); *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989);

(b) other circuits' construction of the Rule's language as a substantive term of the contract or as mere notice; *see, e.g., Ballay v. Legg Mason Wood Walker, Inc.*, 878 F.2d 729 (3d Cir. 1989); *Gooding v. Shearson Lehman Bros. Inc.*, 878 F.2d 281 (9th Cir. 1989); and (c) various courts' attempts to draw distinctions between substantive and notice provisions by examining the precise language involved; *see, e.g., Stander v. Financial Clearing & Services Corp.*, 718 F. Supp. 1204 (S.D.N.Y. 1989). The court then turned to a line of cases from this circuit which have consistently held that the Rule does not create any substantive rights nor does "a party's preference for litigation over arbitration '. . . rise to the level of a substantive right.' " *Jeske v. Brooks*, 875 F.2d 71, 75 (4th Cir. 1989); *see also Ottenritter v. Shearson Lehman Hutton, Inc.*, 727 F. Supp. 980 (D. Md. 1989); *Fisher v. Prudential-Bache Securities Inc.*, 635 F. Supp. 234 (D. Md. 1986); *Shotto v. Laub*, 632 F. Supp. 516 (D. Md. 1986). We are disinclined to depart from that line of reasoning now.

Admittedly, Judge Murray's opinion in *Tauber* did not address the fact, present in *Tauber*, that the precise language set forth in Rule 15c2-2(b), *see* n.3, *supra*, was only required to appear in brokerage agreements until December 31, 1984. But we think that here the district court below construed subsection (b) too broadly in concluding that Rule 15c2-2 must not have required any type of notice after that date and so must be deemed to have served a contractual purpose thereafter. Subsection (b) merely provided a grace period within which brokers were permitted to use preexisting brokerage forms. The obvious implication of such a provision is that after December 31, 1984, brokers should print new forms conforming to the requirements of the Rule if they meant to stay up to date, not that notice language was no longer required, and so the language had to become contractual in nature.

Had the parties entered into brokerage agreements containing the Rule's notice provisions after the Rule had been rescinded in 1987, *see* Sec. Exch. Act Rel. No. 25034, [1987 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 84,163, 52 Fed. Reg. 39, 271 (Oct. 15, 1987), the district court's reasoning would have far more force. Here, however, the agreements were entered into while the Rule was still in effect, rendering

Jeske, Ottenritter, and *Fischer* fully applicable. Obviously, the *Tauber* court reached the same conclusion.

We thus hold that the litigation language contained in the arbitration clauses of the Standard Options Agreements and the Managed Options Agreement entered into by Clark and Merrill Lynch on June 24, 1985, were notice provisions only and did not create a substantive right to litigate federal securities law claims. Like the court in *Tauber*, we find additional support for that conclusion by noting the parties' prior course of conduct in agreeing, in at least eight brokerage agreements entered into between 1981 and 1985, to submit all claims to arbitration, including federal securities law claims.[4] There is nothing in the record to indicate that Clark at any time bargained for an agreement to the contrary.[5]

The district court erred, therefore, in construing the arbitration clause of the Managed Options Agreement as an agreement between the parties to litigate federal securities law claims and in denying Merrill Lynch's motion to compel arbitration of Clark's Section 10(b) claim. Accordingly, we vacate the judgment of the district court and remand the case to the district court with instructions to compel arbitration of the Section 10(b) claim.

VACATED AND REMANDED

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[4] Of course, those agreements entered into while Rule 15c2-2 was in effect were nonetheless enforceable. *Fisher*, 635 F. Supp. at 236.

[5] Indeed, Clark testified at trial that he did not read his brokerage agreements with Merrill Lynch.

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 90-2039

DONALD E. CLARK
Plaintiff—Appellee

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED, a New Jersey corporation; WENDELL C. HOOVER
Defendants—Appellants

On Petition for Rehearing with Suggestion for Rehearing In Banc

The appellee's petition for rehearing and suggestion for rehearing in banc were submitted to the Court. In a requested poll of the Court, Judges Widener, Hall and Sprouse voted to rehear the case in banc; and Judges Ervin, Russell, Phillips, Murnaghan, Chapman, Wilkinson, Wilkins, and Niemeyer voted against rehearing the case in banc. As a majority of the judges voted to deny rehearing in banc, and

As the panel considered the petition for rehearing and is of the opinion that it should be denied,

IT IS ADJUDGED AND ORDERED that the petition for rehearing and suggestion for rehearing in banc is denied. Judge Widener would favor granting rehearing.

Entered at the direction of Judge Murnaghan.

For the Court,

CLERK

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA AT HUNTINGTON

CIVIL ACTION
NO. 3:86-0879

DONALD E. CLARK,

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; and WENDELL C. HOOVER,

Defendants.

MEMORANDUM OPINION AND ORDER

Before the court is the defendants' motion to compel arbitration of plaintiff's claims alleging violations of § 10b of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j(b) (West 1981), and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5 (1986), (hereinafter "securities law claim") and of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C.A. §§ 1962 and 1964 (West 1984), (hereinafter "RICO") and to stay the proceedings in this court. This court, by memorandum opinion and order entered March 18, 1987, previously had ordered arbitration of the other claims asserted by the plaintiff against the defendants. However, we stayed ruling on the motion to arbitrate the securities law and RICO claims pending the Supreme Court's decision in *Shearson/American Express, Inc. v. McMahon*, No. 86-44, *cert. granted*, ____ U.S. ____, ____ S.Ct. ____, 93

L.Ed.2d 20 (1986). Inasmuch as the Supreme Court has rendered its decision, *Shearson/American Express, Inc. v. McMahon*, 482 U.S. ____, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), and the parties have fully briefed its effect on the case *sub judice*, the motion is now ripe for decision.

When ruling on a motion to compel arbitration, this court must first determine whether the parties agreed to abritrate the dispute in question. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). Second, we must determine whether the dispute is in fact one that may be submitted to arbitration. *Mayaja, Inc. v. Bodkin*, 803 F.2d 157, 160 (5th Cir. 1986), *vacated* ____ U.S. ____, 107 S.Ct. 3205, 96 L.Ed.2d 692 (1987); *Creative Securities Corp. v. Bear Stearns & Co.*, 671 F.Supp. 961, 965 (S.D.N.Y. 1987); *Hall v. Prudential-Bache Securities, Inc.*, 662 F.Supp. 468, 470 (C.D.Cal. 1987). The Supreme Court in the *McMahon* case *supra*, has determined that claims alleging violations of the securities laws and of RICO, such as those set forth in the complaint in this present action, are arbitrable. Therefore the only issue that this court must decide is whether the parties agreed to submit such claims to arbitration.[1]

[1] The defendants, in their supplemental memorandum of law of June 29, 1987, at 3, state that the court has already ruled in our memorandum opinion and order of March 18, 1987, that the parties have agreed to arbitrate these claims. While we perceive that the language in the first full paragraph on page 3 of that opinion might be interpreted as so holding, that was not the court's intention. Furthermore, inasmuch as the court did not have before it at that time all the documents relating to the agreements between the parties, *see* Stipulations of Fact of Counsel, Court Document 19, the court would not consider any such ruling, if one had been made, binding on us so as to be the law of the case.

The resolution of this issue is complicated by the fact that apparently the plaintiff had more than one account with the defendant Merrill, Lynch, Pierce, Fenner & Smith, Inc.[2] (hereinafter "Merrill Lynch") and that he signed numerous documents or agreements related to these accounts.[3] Furthermore, many of these documents contained provisions regarding arbitration of disputes between the parties thereto. The last such agreement, a Managed Options Client Agreement, was executed in June, 1985, and contained the following clause:

> 8. Arbitration Clause. Although you have signed a customer agreement form with MERRILL LYNCH that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

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[2] The plaintiff alleges in his complaint that he had three separate accounts with Merrill Lynch, the first one, Account Number 301-67101, subsequently renumbered 301-96101, (hereinafter "the 01 Account"), established on September 1, 1981; the second one, Account Number 671-96169, subsequently renumbered 301-96002 (hereinafter "the 02 Account"), established sometime thereafter; the third one, Account Number 671-16280, subsequently renumbered 671-96172 and then 301-96003 (hereinafter "the 03 Account"), established on January 21, 1985. The defendants admit in their answer the existence of the first two accounts but deny the existence of the third.

The court, in an order entered on September 3, 1987, Court Document 18, acting on the assumption that there were in fact three separate accounts, asked the parties to stipulate as to the complete contract applicable to each account. Counsel for the parties submitted a stipulation in response to the order. Court Document 19. However, in an oblique effort to avoid conceding exactly how many accounts did exist, counsel merely stipulated that the documents submitted were those executed by the plaintiff and Merrill Lynch without specifying which documents applied to which account. Because the documents submitted establish the existence of at least account numbers 301-67101, 671-96169, 301-96002, and 301-96003, the court will assume for purposes of deciding this motion that the plaintiff had three separate accounts with Merrill Lynch.

[3] *See* n.2 *supra*. The court notes in passing that certain documents previously submitted to the court as being copies of agreements entered into by the parties were not included in the stipulation.

Exhibit A to Stipulation of Counsel, Court Document 19. Plaintiff contends that this agreement is the contract controlling the entire relationship between himself and Merrill Lynch and therefore applies to a dispute involving any account he has with Merrill Lynch. In the alternative, he argues that if that client agreement does not in and of itself govern all the accounts it was made applicable thereto by a clause in an option agreement executed contemporaneously with the Customer Agreement. Exhibit B to Stipulation of Counsel. That clause states:

> 11. Any agreement by me with you, whether previously or hereafter made applicable to any account of mine with you, shall also apply to such option transactions except to the extent which it conflicts with this agreement. In the event of a conflict, this agreement shall control, and where there is no conflict, each provision of each agreement shall apply.

Id. He contends that by reading these two documents together paragraph 8 of Exhibit B makes paragraph 11 of Exhibit A controlling as to any other contract between the parties if there should be a conflict between the arbitration clauses of the two contracts. It appears that the defendants also assume that the arbitration clause cited *supra* is applicable to all accounts involved although they contest the effect of the conflicts clause of Exhibit B. Their disagreement with the plaintiff is about the interpretation of the arbitration clause.

Although the court has some question as to the applicability of the Managed Options Client Agreement to the three accounts, given the fact that it contains only the account number of the 03 Account and has no statement of general application, as do the Customer Agreements, Exhibit P, para. 12 & Exhibit Q, para. 17, we will assume for the sake of deciding this motion that it does apply to all three accounts. However, Exhibit A is not the only document that we must review in order to determine whether the parties did or did not agree to arbitrate the securities law and RICO claims. In determining the extent of the parties' agreement to arbitrate, any doubts must be resolved in favor of arbitration. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985); *S. A. Mineracao Da Trindade—Samitri v. Utah International, Inc.*,

745 F.2d 190, 194 (2d Cir. 1984); *Hall v. Prudential-Bache Securities, Inc.*, 662 F.Supp. 468, 470 (C.D.Cal. 1987).

We will start with the documents, other than Exhibit A, that have general application to all the accounts—the Customer Agreements. In Exhibit P, which was executed on September 1, 1981, the plaintiff and Merrill Lynch[4] "agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration. . . ." This is a broad statement without any reservations or exclusions and we believe that it is unnecessary to cite any case law to support the finding that the securities law and RICO claims would be encompassed thereunder.

The arbitration clause in the other Customer Agreement, Exhibit Q,[5] states that "[e]xcept to the extent that controversies involving claims arising under the Federal securities laws may be litigated, it is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration. . . ." *Id.*, para. 13. Plaintiff has argued that, irrespective of the meaning and effect of Exhibit A, the opening clause of that quoted sentence excludes any claim it has asserted in Count I from arbitration because such claim involves controversies arising under the federal securities laws. However, we interpret that language to be advice or notice to the customer that the courts have held that claims involving the securities laws are not subject to binding arbitration agreements. Therefore, if the customer's dispute with his broker involves such a claim, he does not *have* to submit the claim to arbitration but *may* litigate it in court instead. *See Girard v. Drexel Burnham Lambert, Inc.*, 805 F.2d 607, 609-10 (5th Cir. 1986); *Austad v. Drexel Burnham Lambert, Inc.*, 638 F.Supp. 480, 483-84 (N.D.ILL. 1986); *Chandler v. Drexel Burnham Lambert, Inc.*, 633 F.Supp. 760, 762-63 (N.D.Ga. 1985); *Shotto v. Laub*, 632 F.Supp. 516, 523 (D.Md. 1986); *West v. Drexel Burnham Lambert, Inc.*, 623 F.Supp. 26, 26-27

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[4] Although the defendant Hoover was not a signatory to any of the documents involved he is covered by any arbitration agreement, *Creative Securities Corp. v. Bear Stearn & Co.*, 671 F.Supp. 961, 968 n. 11 (S.D.N.Y 1987); therefore, we will refer to the signatories hereafter as "the parties".

[5] Although this agreement is undated, we will assume for the sake of deciding this motion that it was executed after and would modify Exhibit P.

(W.D.Wash. 1985); *Finkle & Ross v. A. G. Becker Paribas, Inc.*, 622 F.Supp. 1505, 1509-10 (S.D.N.Y. 1985). *Contra Scharp v. Cralin & Co.*, 617 F.Supp. 476, 479-80 (S.D.Fla. 1985). However, it does not *exclude* from the agreement securities law claims which may be subject to arbitration. Inasmuch as the Supreme Court has held that securities law claims such as alleged herein may be arbitrated and are subject to an agreement to arbitrate, *Shearson/American Express, Inc. v. McMahon, supra*, that advice in the opening clause has no bearing here. That clause does not exclude Count I from arbitration.

We will now look at the documents related to the individual accounts, beginning with the 01 Account. Exhibits G, H, K, L and M all have broad arbitration clauses calling for arbitration of "any controversy" arising out of the agreement. These are similar to the arbitration clause in Exhibit P and likewise would include plaintiff's securities law claim. The documents submitted related specifically to the 02 Account are Exhibits C and O; both are what plaintiff refers to as Standard Option Agreements. The arbitration clause in Exhibit O, the older of the two in time of signing, calls for arbitration of "[a]ny controversy between us arising out of such option transaction or this agreement. . . . " Again this language is to the same effect as that in Exhibit P and our previous ruling as to its scope applies to Exhibit O. Exhibit C's arbitration clause is very similar to Exhibit Q's and the court's ruling as to its effect applies equally to Exhibit C.

With regard to the 03 Account, besides Exhibit Q—the Customer Agreement—which we have interpreted previously, the only documents applicable are Exhibits A and B. Since Exhibit A is the Managed Options Client Agreement, which is keystone of plaintiff's argument, we will leave it for separate treatment. Exhibit B is another Standard Option Agreement with an arbitration agreement identical to Exhibit C. The opening clause thereof is identical to the beginning clause in the arbitration agreement in Exhibit Q. Consequently, the reasoning applied and ruling made regarding Exhibit Q are also applicable to Exhibit B as though repeated verbatim.

The parties have not advised us as to which account Exhibit F applies and the plaintiff denies the authenticity of

Exhibit D. However, their arbitration provisions are no different than those previously discussed. They therefore do not alter the court's determination that, without considering Exhibit A, under the other contracts or agreements entered into by the parties the plaintiff has agreed to submit all disputes, including his securities law claims, to arbitration.

This brings us to Exhibit A, the Managed Options Client Agreement, which contains the heart of plaintiff's argument against arbitration. Paragraph 11, the arbitration clause, states:

> Although you have signed a customer agreement form with MERRILL LYNCH that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

Plaintiff contends that this language clearly and unambiguously shows that the parties intended and agreed that he did not have to submit to arbitration any claim arising out of alleged violations of securities laws. Instead, they agreed that he could litigate such claim in court. Defendants, on the other hand, contend that this provision was included only because it was required by the Securities and Exchange Commission (hereinafter "SEC"). 17 C.F.R. § 240.15c-2-2 (1987). It is their position that the SEC required brokers to send the notice in paragraph 11 in order to notify customers that courts had held that securities law disputes were not subject to arbitration and that consequently agreements between brokers and customers binding them to arbitrate such disputes were not enforceable. However, since the Supreme Court has now held in *Shearson/American Express, Inc. v. McMahon, supra,* that such disputes are arbitrable and that agreements to arbitrate them are enforceable, the notice required by the SEC was erroneous; therefore, its inclusion by Merrill Lynch in any agreement with plaintiff should not be held to have superseded and rendered void previous agreements to arbitrate *all* disputes.

The court notes that the arbitration clause in Exhibit A is verbatim the language of the notice the SEC required brokers to send to customers who had established accounts before

December 28, 1983. 17 C.F.R. § 240.15c2-2(b)(1987). However, the use of this specific language was mandated only as accompaniment to customer agreement forms preexisting the regulation and then only until December 31, 1984. The Managed Options Client Agreement between the parties evidenced by Exhibit A was entered into in June, 1985. This court finds therefore that the arbitration clause in Exhibit A was not included because of the SEC regulation set out in 17 C.F.R. § 240.15c2-2. Consequently, that clause should be interpreted on its own merits according to the usual rules of construction of contracts.

Paragraph 11 clearly states that the customer is "not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts." Exhibit A. This court finds this language clear and unambiguous. The parties expressly agreed that the customer—plaintiff herein—had the right to litigate disputes between them involving federal securities law issues. *See Hammerman v. Peacock*, No. 84-2724 (D.D.C. July 31, 1985) (available on WESTLAW, DCTU database). Since the parties to this action have represented to the court that this arbitration clause applies to and governs *all* the accounts that the plaintiff had with Merrill Lynch, *see supra* at 4-5, this court finds that the claim asserted in Count I of the complaint is not required to be submitted to arbitration but may be litigated in this court.

Plaintiff contends that this same result should also apply to RICO claim alleged in Count II of his complaint. It is his position that since the predicate acts, 18 U.S.C.A. § 1961(a)(West Supp. 1986), for this claim involve violations of federal securities laws the RICO claim itself "arises under the federal securities laws", Exhibit A para. 11, and consequently is also excluded from arbitration by the parties' agreement.

Prior to the Supreme Court's decision in *Shearson/American Express, Inc. v. McMahon, supra*, several courts held that RICO claims founded on predicate acts involving violations of securities laws were excluded from arbitration. *Tashea v. Bache, Halsey, Stuart, Shields, Inc.*, 802 F.2d 1337 (11th Cir. 1986) (per curiam); *Jacobson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 797 F.2d 1197, 1202-03 (3rd

Cir. 1986). *vacated* ____ U.S. ____, 107 S.Ct. 3204, 96 L.Ed.2d 691 (1987); *Romyn v. Shearson Lehman Brothers, Inc.*, 648 F.Supp. 626, 630-32 (D.Utah 1986). This was done in order to avoid an inconsistency between the handling of securities law claims and RICO claims which involved allegations of violations of the same laws. *Id.* This is analogous to plaintiff's argument that his RICO claim "arises under" the securities laws because the predicate acts therefor involve such laws.

However, some of the ground for this analogy has been cut from under plaintiff by the Supreme Court's holdings in *Shearson/American Express, Inc.* that securities law and RICO claims such as those asserted herein are in fact arbitrable. More importantly for our purposes, we agree with the dissent in *Jacobson* that a RICO claim is separate and distinct from the violations which constitute the predicate acts. 797 F.2d 1197, 1209; *accord, Mayaja, Inc. v. Bodkin*, 803 F.2d 157, 162 n.6 (5th Cir. 1986), *vacated* ____, U.S. ____, 107 S.Ct. 3205, 96 L.Ed. 2d 692 (1987); *Hall v. Prudential-Bache Securities, Inc.*, 662 F.Supp. 468, 472-74 (C.D.Cal. 1987). Therefore, the question of the arbitrability of the RICO claim and of the predicate acts must be considered separately. *Id.* This court believes the same reasoning should be used in determining whether an arbitration agreement covers RICO claims. Inasmuch as the RICO claim is separate from the security law claim and inasmuch as we are to resolve doubts as to the scope of arbitration agreements in favor of arbitration, *see Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983), we find that the RICO claim involved herein does not "arise under the federal securities laws". Therefore, it is not encompassed by the arbitration clause of Exhibit A; instead it is covered by the earlier agreements between the parties and must be submitted to arbitration. Although this may result in piecemeal litigation of plaintiff's claims, that is not a reason to deny enforcement of the parties' agreement to arbitrate. *See Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 216-21 (1985).

The defendants have also asked that the proceedings regarding any claims which are not ordered to arbitration be stayed pending resolution of the arbitration of the other claims. We

do not believe that such a stay is necessary. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. at 221-24.

The court's rulings in this opinion also apply to plaintiff's claims against the defendant Hoover. *Letizia v. Prudential Bache Securities*, 802 F.2d 1185, 1187-88 (9th Cir. 1986).

For the reasons stated in this memorandum opinion, it is ORDERED that:

The defendants' motion to compel arbitration of Count I of the complaint be, and the same hereby is, OVERRULED and DENIED;

The defendants' motion to stay all proceedings in this court concerning Count I of the complaint be, and the same hereby is, OVERRULED and DENIED:

The defendants' motion to compel arbitration of Count II of the complaint and to stay all proceedings in this court concerning Count II be, and the same hereby is, SUSTAINED and GRANTED.

The clerk of the court is directed to mail a certified copy of this order to all counsel of record.

ENTER:

ROBERT J. STAKER
United States District Judge

IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF WEST VIRGINIA AT HUNTINGTON

CIVIL ACTION
NO. 3:86-0879

DONALD E. CLARK,

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC. and WENDELL C. HOOVER,

Defendants.

MEMORANDUM OPINION AND ORDER

The parties have filed motions requesting the court to reconsider our order of February 9, 1988. The defendants ask the court to reverse our ruling denying their motion to compel arbitration of and to stay all proceedings in this court with regard to Count I of the complaint. The plaintiff takes issue with our ruling granting the motion to compel arbitration of and a stay with regard to Count II of the complaint. Inasmuch as the plaintiff has not presented any argument or law in addition to that already presented to and considered by the court in our previous ruling, the plaintiff's motion for reconsideration will be denied without further discussion.

In the defendants' motion, they object to the court's ruling that *none* of plaintiff's securities law claims that he had raised regarding *any* of the accounts he had established with the defendant Merrill Lynch had to be submitted to arbitration. The court had based this ruling on the arbitration clause contained in a Managed Options Client Agreement entered into by the parties on June 25, 1988. Exhibit A to Stipulations of Fact, Court Document Number 19. We found that the parties had clearly agreed therein to exclude from arbitration any dispute the plaintiff had which involved the federal securities law.

Memorandum Opinion and Order of February 9, 1988, Court Document Number 20, at 8-10. We held that that arbitration clause applied to all the accounts plaintiff had with Merrill Lynch based upon our understanding that all the parties had represented to the court, at least implicitly, that the arbitration clause was so applicable. *Id.* at 4-5, 10.

The defendants now emphatically deny that they agree, or have ever agreed, that the arbitration clause found in the Managed Options Client Agreement, Exhibit A, is applicable to any account plaintiff had with Merrill Lynch other than the option account which was established when that agreement was signed. Defendants' Motion for Reconsideration, Court Document Number 21, at 3-4. They dispute plaintiff's contention that the aforesaid arbitration clause was made applicable to previous agreements between the parties and thus to other accounts by a conflicts clause contained in paragraph 8 of Exhibit B to the Stipulation. *Id.* at 4. Instead, it is their position that the other accounts are governed by contracts in which the parties agreed to arbitrate *all* disputes. *Id.* at 4-5. Consequently, the defendants ask the court to amend our previous ruling and to order to arbitration all of the accounts the plaintiff had with Merrill Lynch except for the option account established in June, 1985.

Upon rereading the prior memorandum of law referred to in the defendants' motion for reconsideration, it now appears to the court that our understanding that the defendants agreed that the arbitration clause set forth in Exhibit A was applicable to all accounts involved in this litigation was erroneous. In defense of our reaching this mistaken impression we would point out that the positions taken by the parties, and some of their representations to the court, *see* Memorandum Opinion of February 9, at 3 n.3, have shifted as these proceedings have progressed. Furthermore, the parties have been less than forthright with the court in our attempts to determine how many accounts the plaintiff had with Merrill Lynch and the documents or contracts applicable to each account. *Id.* at 3 n.2; *see* Stipulations of Fact, Court Document Number 19;

Court's Order of September 3, 1987, Court Document Number 18. Be that as it may, we will reconsider our previous ruling regarding the arbitrability of Count I of the complaint in light of the defendants' present position on the issue.

In our Memorandum Opinion of February 9, the court assumed, based on what it could determine from the parties' representations, that the plaintiff had three separate accounts with Merrill Lynch. *Id.* at 3 n.2. This assumption is not now called into question by any of the parties. We also held that two agreements executed by the plaintiff and Merrill Lynch, the Customer Agreements, Exhibits P and Q, were applicable to all three accounts. Memorandum Opinion at 5-6. No party contests that. However, in order to forestall any dispute on this point we wish to make clear that that particular ruling was not based upon any assumption on our part or any perceived representation by the parties. Instead, each Customer Agreement clearly states that "[t]his agreement . . . shall cover individually and collectively all accounts which the undersigned [customer] may open or reopen with [Merrill Lynch]. . . ." Stipulations of Fact, Exhibit P para. 12; Exhibit Q para. 17. We further held that the other relevant documents submitted as exhibits to the stipulation, other than Exhibit A, were applicable only to individual accounts. Memorandum Opinion at 5, 7-8. (This finding did not include Exhibits F and D for which we could not make a determination of applicability.) We then determined that the arbitration clauses found in Exhibits P and Q would require submission to arbitration of all disputes, including claims of securities law violations. Furthermore, the arbitration clauses contained in the documents applicable to individual accounts were to the same effect; consequently they did not alter the scope of the arbitration clauses in the Customer Agreements. Memorandum Opinion at 5-8. No one has taken issue with these determinations insofar as they are concerned with the securities law claims.

The court then determined that the arbitration clause in Exhibit A allowed a customer to litigate, rather than arbitrate, a dispute with Merrill Lynch which involved federal securities law. *Id.* at 8-10. The defendants do not challenge that ruling in their present motion. What they take issue with is the

court's decision that that clause applied to all plaintiff's accounts with Merrill Lynch. It is their position that this clause did not alter or amend previous arbitration agreements entered into by the parties. Instead they contend that the arbitration provision of Exhibit A applies only to the account established by that agreement. It is also possible to interpret their memorandum of law of June 29, 1987, as asserting the argument that arbitration agreements cannot be amended.

"[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). That is a question of what the parties contracted. *Davis v. Chevy Chase Financial Ltd.*, 667 F.2d 160, 165 (D.C. Cir. 1981); *see e.g., Janmort Leasing, Inc. v. Econo-Car International, Inc.*, 475 F.Supp. 1282, 1288 (E.D.N.Y. 1979); *Midland Tar Distillers, Inc. v. M/T Lotos*, 362 F.Supp. 1311, 1312-13 (S.D.N.Y. 1973). A party cannot be compelled to arbitrate an issue he did not agree to submit to arbitration. *Davis, supra.* A court is to make the determination of arbitrability by applying federal substantive law. *Mitsubishi Motors Corp., supra.* Federal law counsels that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . ." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983) (footnote with citations omitted). State law is applicable only insofar as it concerns general contract law. *Perry v. Thomas*, 482 U.S. ____, ____, 107 S.Ct. ____, ____, 96 L.Ed.2d 426, 437 n.9 (1987).

Agreements to submit disputes to arbitration may be amended or modified the same as any other contract. 5 Am.Jur.2d *Arbitration and Award* § 35 (1962); *see S.A. Mineracao Da Trindade-Samitri v. Utah International, Inc.*, 745 F.2d 190, 195-96 (2d Cir. 1984); *Employees Protective Ass'n v. Norfolk & Western Railway*, 571 F.2d 185, 192 (4th Cir. 1977); *Creative Securities Corp. v. Bear Stearns & Co.*, 671 F.Supp. 961, 967 (S.D.N.Y. 1987). Modification of a contract requires the assent of the parties, 17 Am.Jur.2d *Contracts* § 465 (1964); it must be supported by consideration, *id.* § 469; and ordinarily it must be in writing if the contract being modified is in writing. *Id.* § 466.

Exhibit A, which contains the arbitration clause in question, is a contract between the parties entered into when the plaintiff opened a new account with Merrill Lynch. This is according to the defendants' own representations to the court. It seems clear, therefore, that the defendants assented to the arbitration clause and that it was supported by consideration—the opening of the new account. The question is did the arbitration clause amend earlier arbitration agreements entered into by the parties. The court in the Memorandum Opinion of February 9 stated that we had reservations about the applicability of Exhibit A to all the accounts involved herein. We now recognize that our reasoning behind that expression of doubt was erroneous insofar as it applied to the arbitration clause therein and consequently retract that statement.

The arbitration clause in Exhibit A expressly refers to the Customer Agreement between the parties and the scope of the arbitration agreement contained in the Agreement. It also clearly amends the scope of the parties' agreement to arbitrate contained in the Customer Agreement by excluding therefrom "any dispute or controversy that arises under the federal securities laws. . . ." Stipulations of Fact, Court Document Number 19, Exhibit A para. 11. Parties to a contract may modify a part thereof in a later contract. 17 Am.Jur.2d *Contracts* § 459 (1964). "The original contract generally remains in force except as modified or superseded by the new agreement." *Id.* at 925 (footnote with citations omitted). Where a contract refers to an earlier contract between the parties the two agreements should be read together. *See S. A. Mineracao Da Trindade-Samitri*, 745 F.2d at 196. This court finds that the parties clearly intended to, and did, amend the arbitration clauses contained in the Customer Agreements by the arbitration clause set out in Exhibit A. (The effect of the latter clause has already been determined and does not need to be repeated here.) We have already shown how the Customer Agreements, by their own terms, applied to all the accounts plaintiff had with Merrill Lynch. Therefore, the arbitration clauses of the Customer Agreements as amended by the arbitration clause of Exhibit A applied to all such accounts. Because the amended arbitration clauses excluded disputes involving federal securities laws, the plaintiff, by contract, is not required to submit to arbitration any of his claims of federal securities law violations

involving *any* of his accounts with Merrill Lynch. This determination is not affected by the arbitration clauses in other documents because of our previous determination that such clauses do not alter the arbitration clauses contained in the Customer Agreements.

For the reasons set forth above, it is ORDERED that the motions for reconsideration filed by the plaintiff and by the defendants be, and the same hereby are, OVERRULED and DENIED.

The clerk of the court is directed to mail a certified copy of this order to all counsel of record.

ENTER:

ROBERT J. STAKER
United States District Judge

Title 17—Commodity and Securities Exchanges;
Revised as of April 1, 1987

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

Subpart A—Rules and Regulations Under the Securities Exchange Act of 1934

RULES RELATING TO OVER-THE-COUNTER MARKETS

§ 240.15c2-2 Disclosure regarding recourse to the courts notwithstanding arbitration clauses in broker-dealer customer agreements.

17 CFR 240.15c2-2

(a) It shall be a fraudulent, manipulative or deceptive act or practice for a broker or dealer to enter into an agreement with any public customer which purports to bind the customer to the arbitration of future disputes between them arising under the Federal securities laws, or to have in effect such an agreement, pursuant to which it effects transactions with or for a customer.

(b) Notwithstanding paragraph (a) of this section, until December 31, 1984 a broker or dealer may use existing supplies of customer agreement forms if all such agreements entered into with public customers after December 28, 1983 are accompanied by the separate written disclosure:

> Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the Federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

(c) A broker or dealer shall not be in violation of paragraph (a) of this section with respect to any agreement

entered into with a public customer prior to December 28, 1983 if:

(1) Any such public customer for whom the broker or dealer has after July 1, 1983 (i) carried a free credit balance, or (ii) held securities for safekeeping or as collateral, or (iii) effected a securities transaction is sent, no later than December 31, 1984, the disclosure prescribed in paragraph (b) of this section; or

(2) Any other public customer is sent upon the completion of his next transaction pursuant to such agreement, the disclosure prescribed in paragarph (b) of this section.

SOURCE: 48 FR 53406, Nov. 28, 1983

AUTHORITY: Secs. 2, 10, 15, 23 and 29 thereof (15 U.S.C. 78b, 78j, 78o, 78w and 78cc)

Rescission of Rule Governing Use of Predispute Arbitration Clauses in Broker-Dealer Customer Agreements.

Exchange Act Release No. 25034. October 15, 1987. Release in full text.

Arbitration—Broker-Dealers—Customer Agreements.—In light of a recent U.S. Supreme Court ruling, the SEC has rescinded a rule requiring brokers to disclose that clauses in customer agreements mandating arbitration of disputes are inapplicable to federal securities law claims. The rescission of Rule 15c2-2 is effective upon *Federal Register* Publication.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is announcing the rescission of Rule 15c2-2 [17 CFR 240.15c2-2] concerning the use of predispute arbitration clauses since, in light of the development of case law, the rule is no longer appropriate.

DATE: (Effective upon publication in the Federal Register).

FOR FURTHER INFORMATION CONTACT: Robert Love, (202) 272-3064, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. DISCUSSION

The Commission is rescinding § 240.15c2-2 of the Code of Federal Regulations (17 CFR 240.15c2-2). Rule 15c2-2 was adopted by the Commission in 1983[1] in order to address regulatory concerns arising from the inclusion in standard form customer agreements of predispute arbitration clauses (*i.e.*, agreements requiring customers to submit to arbitration all future disputes.) In light of the fact that then existing case law generally held that predispute agreements to arbitrate claims arising under the Securities Act of 1933 and the Securities Exchange Act of 1934 ("Exchange Act") were void and unenforceable,[2] the Commission determined that their inclusion in customer contracts without disclosure of their inapplicability to federal securities law claims was misleading, thus constituting a "fraudulent, manipulative or deceptive act or practice" within the meaning of the Exchange Act.[3]

On June 8, 1987, the Supreme Court held in *Shearson/American Express v. McMahon*[4] that predispute agreements to arbitrate claims arising under the Securities Exchange Act of 1934 are enforceable. In addition, although the Court

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[1] Securities Exchange Act of 1934 Release No. 20397, November 18, 1983, 48 FR 53404.

[2] *See Wilko v. Swan*, 346 U.S. 427 (1953); *Moran v. Paine Webber Jackson & Curtis*, 389 F.2d 242 (3d Cir. 1968); *Greater Continental Corp. v. Schecter*, 422 F.2d 1100 (2d Cir. 1970); *Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178 (2d Cir.), *cert. denied*, 385 U.S. 817 (1966); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532 (3d Cir.), *cert. denied*, 429 U.S. 1010 (1976); *Sibley v. Tandy Corp.*, 543 F.2d 540 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831 (7th Cir. 1977); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017 (6th Cir. 1979); *DeLancie v. Birr, Wilson & Co.*, 648 F.2d 1255 (9th Cir. 1981) (dictum); *Ingbar v. Drexel Burnham Lambert, Inc.*, 683 F.2d 603 (1st Cir. 1982) (same); and *First Heritage Corp. v. Prescott, Ball & Turben*, Fed. Sec. L. Rep. (CCH) § 99,404 (6th Cir. 1983). *But cf., Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

[3] Securities Exchange Act Release No. 20397 (November 18, 1983).

[4] 482 U.S. (1987).

did not expressly overrule *Wilko v. Swan*,[5] which held that predispute agreements to arbitrate claims arising under Section 12(2) of the Securities Act of 1933 were not enforceable, the Court's reasoning raised questions regarding the continuing vitality of that decision. In light of these developments, the commission believes that Rule 15c2-2 is no longer appropriate or accurate and, accordingly, should be rescinded.

The Commission finds that notice and public procedures are unnecessary in the public interest because Rule 15c2-2 is no longer appropriate in light of case law developments.[6] Moreover, rescission of the rule may become effective upon publication in the Federal Register since it relieves a restriction.[7] The Commission further finds that this action will not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[8]

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17 Chapter II of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT of 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: Sec. 23, 48 Stat. 901, as amended; 15 U.S.C. 78w, unless otherwise noted.

2. Section 240.15c2-2 is removed.

By the Commission.

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[5] 346 U.S. 427 (1953).

[6] See 5 U.S.C. § 553(b)(3)(B).

[7] See 5 U.S.C. § 553(d)(1) and (d)(3).

[8] See 15 U.S.C. § 78w(a)(2).

Supreme Court, U.S.
FILED
JUL 9 1991
OFFICE OF THE CLERK

(2)

No. 90-1890

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

DONALD E. CLARK,

Petitioner,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., and WENDELL C. HOOVER,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

RICHARD H. SINKFIELD

ROGERS & HARDIN
2700 Cain Tower
Peachtree Center
229 Peachtree Street, N.E.
Atlanta, Georgia 30303
(404) 522-4700

Counsel of Record for Respondents

25 pp

QUESTIONS PRESENTED FOR REVIEW

The Respondents do not agree that this case presents the questions identified by the Petitioner. The case presents the following questions:

1. Whether the language of the agreements between Petitioner and Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch") is sufficient to overcome the presumption in favor of arbitration so that litigation of Petitioner's claim under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), is required.

2. Whether the language of the agreements between Petitioner and Respondent Merrill Lynch which was inserted to comply with Securities and Exchange Commission Rule 15c2-2, 17 C.F.R. § 240.15c2-2, was simply notice of the SEC's position and not a substantive clause of the contract.

LIST OF PARTIES TO THE PROCEEDING

The Petitioner has correctly identified the parties before the Fourth Circuit. Pursuant to Rule 29.1 of the Rules of this Court, the Respondents submit the following list of all parent companies and subsidiaries (except wholly owned subsidiaries) of Respondent Merrill Lynch, Pierce, Fenner & Smith, Inc.:

Parent: Merrill Lynch & Co., Inc.

Subsidiaries: Merrill Lynch Nomura Management Co., Inc.
Wagner Stott Clearing Corp.

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IN THE

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OCTOBER TERM, 1990

DONALD E. CLARK,

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v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., and WENDELL C. HOOVER,

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

OPINION BELOW

The opinions below are set out in the Appendix to the Petition for Certiorari. The Respondents note that, on pages 16a and 17a of the Appendix, the numbers of the paragraphs which quote from two different brokerage agreements are reversed, *i.e.*, the paragraph numbered "8" on page 16a should be numbered "11," and the paragraph numbered "11" on page 17a should be numbered "8."

STATUTES AND REGULATIONS INVOLVED

In addition to Securities and Exchange Commission Rule 15c2-2, 17 C.F.R. § 240.15c2-2 (rescinded), the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*, is involved in this case.

STATEMENT OF THE CASE

The Respondents do not agree that the Petitioner's Statement of the Case is sufficient to outline the questions presented for review. The Respondents therefore provide the following statement:

The Litigation Between the Parties

Petitioner Clark traded securities through Respondents Merrill Lynch and Hoover from 1981 through 1985. Mr. Clark's trading during 1985 gave rise to a dispute between the parties, which in turn led to litigation. The District Court sent all of Mr. Clark's claims to arbitration except his claim under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). The District Court tried the Section 10(b) claim to a jury, and Mr. Clark obtained a substantial verdict in his favor. Merrill Lynch and Mr. Hoover appealed to the Fourth Circuit, which concluded that the federal securities claim should have been sent to arbitration along with the rest of Mr. Clark's claims. The Fourth Circuit vacated the District Court's judgment and remanded the case with instructions for the District Court to compel arbitration of the Section 10(b) claim.

From 1981 to 1985, Mr. Clark signed numerous brokerage agreements with Merrill Lynch. All agreements executed prior to 1985 — eight in total — provided that "any controversy" arising out of Mr. Clark's transactions shall be arbitrated. Under these agreements, there is no dispute: all of Mr.

Clark's claims, including his Section 10(b) claim, are subject to arbitration.

Mr. Clark executed four additional agreements in the first half of 1985 which provided:

> Except to the extent that controversies involving claims arising under the Federal Securities Laws may be litigated, . . . any controversy between us . . . shall be settled by arbitration. . . .

The District Court concluded that this clause advised the customer "that the courts have held that claims involving the securities laws are not subject to binding arbitration agreements." Appendix to the Petition, p. 18a. The District Court also ruled that the clause did *not* exclude from the agreement to arbitrate any securities claims which in fact were subject to arbitration. Appendix to the Petition, p. 19a. Accordingly, the District Court held that, in light of this Court's decision in *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987), Mr. Clark's claim under Section 10(b) would be subject to arbitration under this clause. Mr. Clark did not appeal this ruling to the Fourth Circuit, and he did not argue to the Fourth Circuit that this ruling was incorrect. In his Petition to this Court, he glosses over this language, this ruling, and his failure to attack it.

The primary events giving rise to this lawsuit occurred in January 1985. Several months later, on June 24, 1985, Mr. Clark executed a Managed Options Agreement. On the same day, he signed two Standard Option Agreements containing the arbitration clause quoted above. The Managed Options Agreement states:

> Although you have signed a customer agreement form with MERRILL LYNCH that states that you are required to arbitrate any future dispute or

> controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

The District Court ruled that Mr. Clark's entire claim under Section 10(b) should be tried under the Managed Options Agreement. In so ruling, the District Court disregarded language in the Standard Option Agreements, signed the same day, that provided that *they* would control in the event of a conflict:

> Any agreement by me with you, whether previously or hereafter made applicable to any account of mine with you, shall also apply to such option transactions except to the extent which it conflicts with this agreement. ***In the event of a conflict, this agreement shall control***, and where there is no conflict, each provision of each agreement shall apply. (Emphasis supplied.)

This conflict clause appeared not only in the Standard Option Agreements that contained the first "qualified" arbitration clause quoted above but also in other Standard Option Agreements that Mr. Clark had previously signed and that provided that "any controversy" would be arbitrated.

The Respondents appealed to the Fourth Circuit, which held that the qualified arbitration clauses found in the Standard Options Agreement and the Managed Options Agreement "were notice provisions only [under SEC Rule 15c2-2] that did not create a substantive right to litigate federal securities law claims." (Appendix to the Petition, p. 12a.) The Fourth Circuit concluded that arbitration was required under either clause so that there was no conflict between the clauses. The Fourth Circuit did not examine the specific

language of either clause to determine whether, if it were a substantive term of the contract, it required arbitration.

As the Fourth Circuit noted in its opinion of January 31, 1991, Mr. Clark testified that he did not read his brokerage agreements (Appendix to the Petition, p. 12a n. 5), and there is no evidence in the record that he bargained for anything other than arbitration. This is particularly true given the parties' course of conduct in agreeing, in at least eight brokerage agreements signed over a four-year period, to submit *all* claims to arbitration. (Appendix to the Petition, p. 12a.)

SEC Rule 15c2-2

This Court held in 1953 that certain claims under the Securities Act of 1933 could not be arbitrated. *Wilko v. Swan*, 346 U.S. 427 (1953). Other courts extended that holding to claims under the Securities Exchange Act of 1934. *See, e.g.*, cases cited in *McMahon*, 482 U.S. at 225 n.1. Because of those cases, the SEC, effective January 1, 1984, adopted Rule 15c2-2, entitled "Disclosure regarding recourse to the courts notwithstanding arbitration in broker-dealer customer agreements." The SEC adopted Rule 15c2-2 to require brokers to advise parties to arbitration agreements of the SEC's (erroneous) assumption that federal securities claims were not subject to arbitration. The SEC repealed its rule after this Court held, in *McMahon*, 482 U.S. at 238, that claims under § 10(b) were subject to arbitration. *See* Exchange Act Rel. No. 25034, [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,163 (Oct. 15, 1987) (SEC rescinded Rule 15c2-2 as "no longer appropriate in light of case law developments.") (Appendix to the Petition, p. 33a.)

Rule 15c2-2 contained specific language that the SEC required brokers to send to their customers before Decem-

ber 31, 1984 if the customer did not sign a new contract containing similar language. The notice stated:

> Although you have signed a customer agreement form with FIRM NAME that states that you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any such dispute or controversy through litigation in the courts.

17 C.F.R. § 240.15c2-2(b). Rule 15c2-2 also provided a grace period until December 31, 1984 for brokerage firms to use their already-printed customer agreements, so long as the notice prescribed above was also given to customers. As the Fourth Circuit concluded, brokerage firms were required after December 31, 1984 to incorporate notice language into their printed customer agreements. (Appendix to the Petition, p. 11a.)

In response to the rule, many brokerage firms placed the specified language or other qualifying language in arbitration agreements. *See Ottenritter v. Shearson Lehman Hutton, Inc.*, 727 F. Supp. 980, 984 (D. Md. 1989). The firms used many different forms of disclosure language, and two different forms were used in Mr. Clark's agreements. The language included in Mr. Clark's Managed Options Agreement is the very language prescribed by Rule 15c2-2 for the notice to customers. The language included in the Standard Options Agreement, as the Fourth Circuit found, is another form of disclosure language used by Merrill Lynch to comply with the rule.

In sum, Rule 15c2-2 was not a substantive provision determining arbitration rights, but was instead a rule requiring disclosure of a view of the law that ultimately was shown to

be incorrect. Mr. Clark signed many agreements to arbitrate claims arising from trading at Merrill Lynch. A number of those agreements were unqualified and, without question, required arbitration of all disputes. The few agreements that contained a qualified arbitration clause were the product of Merrill Lynch's compliance with the notice requirements of Rule 15c2-2.

SUMMARY OF THE ARGUMENT

The Court should deny certiorari because the special facts and circumstances of this case render it an inappropriate candidate for further review. First, Rule 15c2-2 has been rescinded for almost four years, and agreements drafted to comply with it soon should pass from the scene. Thus, disputes about the meaning and effect of language used by brokerage houses to comply with the SEC's rule should not have any long-term effect on the law. Likewise, the division among the Courts of Appeals about the results of compliance with the SEC's rule should not have any long-term effect. The issue is of limited and receding importance.

Second, the Fourth Circuit has compelled arbitration of Mr. Clark's federal securities law claim in this case in accordance with his repeated agreements to arbitrate. Brokerage firms used many forms of language to comply with Rule 15c2-2. Contrary to the clear implication of Mr. Clark's Petition, the controlling contractual clause in this case calls for arbitration. Thus, aside from the issue of whether language used to comply with Rule 15c2-2 is notice rather than a substantive clause of the contract, the actual language used in Mr. Clark's agreements in this case leads to the conclusion that the result in this case is correct. The Fourth Circuit's judgment is correct for this reason as well as for the reasons given by the Court of Appeals.

Third, the Fourth Circuit's ruling in this case puts to rest the lingering effects of an SEC rule that was based on the erroneous assumption that federal securities claims were not subject to arbitration. The Fourth Circuit has reached a fair and just result with respect to the effects of Rule 15c2-2. The Fourth Circuit's decision also advances the clear federal policy in favor of arbitration.

Finally, contrary to the Petitioner's contention, the Fourth Circuit has not intruded into the realm of private contract. The Fourth Circuit simply construed the agreements between the parties, and it did not re-write the agreements or in any way make a new agreement for the parties.

ARGUMENT

Mr. Clark asks the Court to grant certiorari in this case on the ground that the Fourth Circuit's decision conflicts with decisions of other circuits and is incorrect. He over-emphasizes the scope and importance of the question raised, and he incorrectly assumes that the language of his contract, if read as a substantive term of his contract, gives him a right to litigate his claim. The Court should deny Mr. Clark's petition.

1. *Rule 15c2-2 Is Largely A Past Question.*

Rule 15c2-2 was adopted in 1984 and rescinded in 1987. Only contracts that were made during that period (and not superseded by later agreements) are affected by the question of whether language inserted to comply with the rule constitutes mere notice of the SEC's view or is instead a substantive clause of the contract. The question was of "considerable current interest" in the marketplace immediately after this Court's decision in *McMahon* (*see Ballay v. Legg Mason Wood Walker, Inc.*, 878 F.2d 729, 730 (3d Cir. 1989)), but

as Rule 15c2-2 recedes into the past, so will the question presented by this case. In other words, this case is clearly important to the parties, but it should not have any long-term effect on the law.

Beyond the question of whether language inserted to comply with Rule 15c2-2 was mere notice, this case presents only a question of construing specific language of a contract. Brokerage firms used many different forms of language to comply with Rule 15c2-2, and the interpretation of the substantive meaning of one such clause should not greatly affect interpretation of other clauses. In other words, the question of contract construction is largely a case-by-case question.

2. *Mr. Clark's Agreements Call for Arbitration.*

After the Fourth Circuit held that the qualified language in Mr. Clark's agreements was only notice required by the SEC and did not create any substantive contractual rights, the Court of Appeals did *not* further construe the various contracts signed by Mr. Clark. At that point, the specific notice language used was no longer in issue. If the language of Mr. Clark's arbitration clauses is examined, however, and if the presumption in favor of arbitration is followed, then the Court of Appeals was in all events correct in compelling arbitration of the Section 10(b) claim. The Respondents will address this issue before addressing the actual holding of the Fourth Circuit in this case because the Petitioner has strongly implied that, but for the Fourth Circuit's ruling that language used to comply with Rule 15c2-2 is notice only, he would not be compelled to arbitrate his claim under Section 10(b). Mr. Clark is wrong because arbitration is required by the language of his agreements with Merrill Lynch, independent of the conclusion that the clauses are mere notice.

The determination of whether the parties have agreed to arbitrate a dispute is guided by a strong federal policy *in favor of* arbitration. This Court firmly expressed this view in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983):

> The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.

This Court thus follows a presumption in favor of arbitration. "[A]s with any other contract, the parties' intentions control, but those intentions are generously construed as to issues of arbitrability." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). As a result, Mr. Clark's agreements with Merrill Lynch must be read with a view toward arbitration. In other words, unless the language of Mr. Clark's agreements requires litigation, arbitration should be ordered. The federal policy is clear and indisputable.

The District Court recognized the federal policy in favor of arbitration and found that, under twelve agreements that Mr. Clark signed, his federal securities claim was arbitrable. Thus, the District Court construed all of Mr. Clark's agreements but one to provide for arbitration. Mr. Clark did not contest that ruling before the Fourth Circuit. He neither cross-appealed nor argued that this construction was not correct.

Any confusion about arbitration in this case was caused by Rule 15c2-2 and centers on the language of the Managed Options Agreement, which is only *one* of Mr. Clark's thirteen

arbitration agreements. Thus, the District Court premised its ultimate ruling against arbitration on its conclusion that Mr. Clark's Managed Option Agreement superseded all other agreements and prevented arbitration of Mr. Clark's claim. Mr. Clark executed the Managed Options Agreement on the very same day that he executed two Standard Option Agreements. Mr. Clark had previously executed three other Standard Option Agreements for his accounts. Each of these Standard Option Agreements provided that *it* was to control in the event of a conflict with any other agreement. (See language cited p. 4, *supra*). *See Stifel, Nicolaus & Co. v. Freeman*, 924 F.2d 157, 159 (8th Cir. 1991) (giving effect to conflict resolution clause to compel arbitration). If the Managed Option Agreement is interpreted to exclude arbitration, there would then be a conflict with the controlling arbitration language in the Standard Option Agreements. Thus, three of the Standard Option Agreements contained unqualified language compelling arbitration, while the other two contained language stating that "[e]xcept to the extent that controversies involving claims arising under the Federal securities laws may be litigated," all claims were to be arbitrated. Under the undisputed ruling of the District Court, any of the Standard Option Agreements compels arbitration of Mr. Clark's federal securities claim. Mr. Clark is clearly incorrect in implying in his Petition that only the Fourth Circuit's ruling on Rule 15c2-2 notice language compels arbitration in this case. The undisputed record before the Court of Appeals presented a case with no controversy as to the meaning of the arbitration clause in the controlling Standard Options Agreement. Furthermore, the case pre-

sented no controversy as to the governing policy in favor of arbitration.[1]

Thus, even if the Fourth Circuit incorrectly characterized the Rule 15c2-2 language of the agreements as "notice only" rather than "substantive," its decision compelling arbitration of Mr. Clark's claim is correct. The language of the Standard Option Agreements, in and of itself calls for arbitration. The District Court so held, and Mr. Clark did not contend otherwise before the Fourth Circuit. Mr. Clark repeatedly agreed to arbitrate, and the Fourth Circuit's decision is correct for that reason if for no other.

3. *The Case Law in the Courts of Appeals*

The Fourth Circuit, in any event, reached a fair and appropriate result in ruling on the effect of Rule 15c2-2. The Petitioner's discussion of the applicable case law requires this supplemental discussion by the Respondents. The Petitioner is correct in noting a conflict among the circuits, but he misstates the issue and overstates the conflict.

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[1] The District Court's construction of the qualified language of the Standard Option Agreement is supported by decisions of other district courts. *See Axtell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 744 F. Supp. 194, 197-98 (E.D. Ark. 1990); *Nemes v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 741 F. Supp. 657, 658-60 (E.D. Mich. 1990); *Esposito v. Hyer, Bikson & Hinsen, Inc.*, 709 F. Supp. 1020, 1021-22 (D. Kan. 1988). *But compare Blue Gray Corps. I and II v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 921 F.2d 267 (11th Cir. 1991) (reaching opposite conclusion). While the Respondents believe that the district courts' construction of the language is correct, the language is *at least* sufficiently ambiguous that arbitration must be ordered under the strong federal policy favoring arbitration. As previously noted, the District Court construed this language to call for arbitration, and Mr. Clark did not contest this conclusion on appeal to the Fourth Circuit.

First, contrary to the Petitioner's contention, the Fourth Circuit did *not* hold that the SEC's rescission of its rule invalidated anyone's contractual agreement to litigate. The Fourth Circuit instead held that language inserted in a contract by a brokerage firm in order to comply with the SEC's rule was notice of the SEC's view and was not a substantive term of the contract. The Fourth Circuit did not re-write the agreement between the Petitioner and Respondent Merrill Lynch. Instead, it construed the contracts in light of their history and the SEC's rule. That does not alter or change the contracts in any way. It merely gives effect to the language as it stood from the beginning.

Second, the Fourth Circuit does not stand against a majority of the circuits, and the circuits' views are not so consistent or uniform as the Petitioner suggests. Thus, the Second Circuit, without discussion, held that language under Rule 15c2-2 that excluded securities claims from an arbitration clause is mere notice and creates no substantive rights. *Bird v. Shearson Lehman/American Express, Inc.*, 871 F.2d 292, 295 n. 5 (2d Cir. 1989). While this Court vacated the Second Circuit's judgment on other grounds, __ U.S. __, 110 S.Ct. 225 (1989), the Second Circuit has not since expressed a different view. *See Bird v. Shearson Lehman/American Express, Inc.*, 926 F.2d 116, 118 (2d Cir.), *cert. denied*, No. 90-1701 (U.S. June 28, 1991). In addition, one of the decisions cited by Mr. Clark does not even address the question at hand. *Giles v. Blunt, Ellis & Loewi, Inc.*, 845 F.2d 131 (7th Cir. 1988), makes no mention of SEC Rule 15c2-2 and clearly does not consider the effect of the rule on the contract in that case.

The Petitioner also does not accurately address the Fourth Circuit's earlier decision in *Jeske v. Brooks*, 875 F.2d 71 (4th Cir. 1989), and *Jeske*'s relationship to the decisions of other

circuits. The agreement in that case was already in effect when the SEC adopted Rule 15c2-2, and it called for arbitration of all disputes. The Fourth Circuit held that the agreement was *not* affected by the subsequent adoption of the rule, even though the agreement also provided that any of its provisions would be deemed "rescinded or modified" to the extent that they conflicted with laws or regulations. 875 F.2d at 75. The Fourth Circuit applied the SEC's rescission of the rule retroactively and treated the rule as though it had never existed. The Fourth Circuit did not examine whether the broker had complied with the requirements of the rule while it was in effect, and it flatly held that the rule did not create any substantive rights. "[A] party's preference for litigation over arbitration 'does not rise to the level of a substantive right.' " *Id.* (citation omitted).

In this case, the Fourth Circuit logically and fairly applied the principles of its earlier *Jeske* decision when it continued to decline to give substantive effect to a rule that (1) was adopted as the lower courts were changing their view of arbitration of securities claims; (2) was based on the erroneous assumption that such claims were not arbitrable; (3) was of questionable validity from the outset; and (4) has been rescinded. The Fourth Circuit held that the various forms of language employed to comply with the rule were no more than notice of the SEC's position, and it declined to give substantive effect to regulatory language that brokers were required to insert into contracts with their customers. That is wholly appropriate for a rule that is now a dead letter. Moreover, it is entirely appropriate to effectuate the strong federal policy *in favor of* arbitration. *Moses H. Cone Memorial Hosp.*, 460 U.S. at 24-25; *see also Mitsubishi Motors Corp.*, 473 U.S. 614 at 626.

Jeske finds support in the decisions of other circuits. The Eleventh, Ninth, and Fifth Circuits, confronted with the issue, have reached the same result as *Jeske*. *Adrian v. Smith Barney, Harris, Upham & Co.*, 841 F.2d 1059 (11th Cir. 1988); *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282, 288 (9th Cir. 1988); *Villa Garcia v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, 833 F.2d 545 (5th Cir. 1987). *But see Coffey v. Dean Witter Reynolds, Inc.*, 891 F.2d 261 (10th Cir. 1989), *cert. denied*, __ U.S. __, 111 S.Ct. 43 (1990) (reaching opposite conclusion). Admittedly, the Eleventh, Ninth, and Fifth Circuits, while agreeing with the result in *Jeske*, would approach *this* case differently than the Fourth Circuit. But their position is internally inconsistent and promotes litigation, unlike the Fourth Circuit's decision in this case. On the one hand, those courts treat rescission of Rule 15c2-2 as retroactive and fully effective if the contract provides for arbitration of all disputes, with no qualifying language. In that instance, the contract is enforced without regard for the presence of the rule during some portion of the life of the contract and without regard for compliance or non-compliance with the rule. On the other hand, those courts (and the Third Circuit in *Ballay v. Legg Mason Wood Walker, Inc.*, 878 F.2d 729 (3d Cir. 1989)) treat efforts by brokerage firms to comply with Rule 15c2-2 as a substantive term of the contract and thus as a term affecting arbitration. In other words, if a broker made no effort to comply with the SEC rule mandating disclosure language in the contract, those courts would enforce arbitration clauses of the broker. But if the broker included SEC-required notice language in the contract, then the SEC-required notice becomes a substantive clause that may undo the agreement to arbitrate, depending upon the particular language used.

This approach leads to the anomalous result of rewarding noncompliance with the rule and punishing compliance. At the same time, this approach could encourage litigation to construe the different phrases used by brokerage houses in attempting to comply with the rule. This approach also does *not* promote the federal policy in favor of arbitration.

The result in this case, on the other hand, advances the federal policy in favor of arbitration. It declines to give effect to a now-rescinded SEC rule that was premised on an erroneous view of the law. It neither rewards non-compliance with the rule nor punishes compliance, and it does not encourage further litigation. The result in this case also gives effect to repeated agreements between the parties to arbitrate their disputes. The result in this case is fair and appropriate.

4. *The Fourth Circuit's Decision Does Not Intrude Into The Right of Private Contract.*

Petitioner suggests that the Fourth Circuit has set aside a contract between the parties and has improperly intruded into the right of private contract. That is clearly not correct. As previously discussed, the Fourth Circuit did not re-write the agreements between the Petitioner and Respondent Merrill Lynch. The Fourth Circuit instead construed the agreements in light of their history and the SEC's rule requiring notice. The Fourth Circuit found that the qualifying language on which Mr. Clark relied to avoid arbitration was only notice of the SEC's position and was not a substantive clause of the contract. That does not alter or change the contract in any way. It merely construes it.

CONCLUSION

The Fourth Circuit has put Rule 15c2-2 in the past. The Court of Appeals reached a fair and logical result in disposing of an issue that arose only because the SEC sought to impose an erroneous view of the law onto contracts between brokers and their customers. While the Fourth Circuit's decision conflicts with certain other appellate cases, that conflict should have no long-term effect on the law since its pertains only to brokerage agreements executed during the period from 1984 to 1987 and which have not been superseded. The question, while of interest immediately after the SEC rescinded its rule, is of limited and receding importance.

In addition, the controlling arbitration clause in this case, properly construed, calls for arbitration and not litigation. Even if the Fourth Circuit had erroneously put Rule 15c2-2 to rest, the result in this case would not change. Mr. Clark repeatedly agreed to arbitrate any dispute with the Respondents, and there is no evidence in the record to suggest that he bargained for anything other than arbitration. Indeed, he testified that he did not even read his brokerage agreements.

Finally, this case does not present any question about judicial interference in private contracts. The Fourth Circuit did not hold that rescission of Rule 15c2-2 changed a substantive clause of a contract into a notice clause and thus worked a change in the parties' agreement. The Fourth Circuit instead held that the contract's language was (and always had been) notice only. The Fourth Circuit simply construed the contract as agreed to, and it did not rewrite the agreement.

The Court should deny the Petition for Certiorari.[2]

Respectfully submitted,

ROGERS & HARDIN

RICHARD H. SINKFIELD
Counsel of Record for
Respondents

PAUL W. STIVERS

JAMES W. BEVERAGE

Rogers & Hardin
2700 Cain Tower
Peachtree Center
229 Peachtree Street, N.E.
Atlanta, Georgia 30303
Telephone: (404) 522-4700

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[2] The Fourth Circuit did not decide certain additional issues in this case that would arise only if the jury's verdict were reviewed on its merits. For example, Merrill Lynch and Mr. Hoover strongly contend that Mr. Clark's claimed damages at trial were unsupported by evidence and were based on contradictory theories. These questions are not before the Court and would be before the Fourth Circuit only if the Court were to grant the petition for certiorari and reverse the Fourth Circuit's decision.

Supreme Court, U.S.
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No. 90-1890

IN THE

Supreme Court of the United States

October Term, 1990

DONALD E. CLARK

Petitioner,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., and WENDELL C. HOOVER

Respondents.

Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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Petitioner's Reply to Brief in Opposition

DAVID KENT HIGGINS
ROBINSON & MCELWEE
P.O. Box 1791
Charleston, WV 25326
(304) 344-5800
Counsel of Record for Petitioner

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REPLY BRIEF

Pursuant to Rule 15.6, Petitioner is permitted to file a reply brief addressed solely to arguments raised for the first time in the brief in opposition. Of the four legal arguments raised in the brief in opposition, two were not raised in the Petition for Writ of Certiorari.

Respondents argue that despite the existence of a "split" among the circuits, the issue presented is, in the language of the Respondents, "largely a past question." Respondents also argue that even if the decision by the Fourth Circuit in this case is incorrect, the specific language contained in the applicable brokerage agreements nonetheless requires arbitration of Petitioner's federal securities law claims. Neither of these arguments were addressed in the petition.

SUMMARY OF REPLY

When, as is the case here, an issue has been addressed by seven circuit courts and numerous district courts, such an issue has obvious nationwide impact and accordingly has significance far beyond the personal interest attached to the issue by the litigants in the case at bar. Furthermore, the question of whether contractual provisions that were inserted in response to regulation can be summarily disavowed upon subsequent change or repeal of the regulation is of clear importance in the area of administrative law generally and is of great interest to those affected by the regulatory actions of state and federal agencies.

The argument by Respondents, that even if the Fourth Circuit decision in this case is incorrect the language of the contract itself requires arbitration of federal securities law claims, is manifestly without merit. Merrill Lynch admits that the purpose of Rule 15c2-2 was to exclude federal securities law claims from arbitration agreements. Merrill Lynch also admits that it inserted the language at issue into Petitioner's agreements in response to the SEC rule. It is, therefore, futile for Merrill Lynch to now argue that the subject language does not exclude federal securities law claims from arbitration.

REPLY ARGUMENT

1. *The Issue Presented Merits Review by this Court.*

At page 12 of their brief in opposition, Respondents admit that there is a conflict among the circuits on precisely the issue presented in this case. With five circuits aligned against the Fourth Circuit, it is clear that the issue has sufficient merit to warrant review by this Court. The existence of a conflict among the circuits is well-recognized as sufficient grounds for review by this Court. Rule 10.1(a) of the Rules of this Court states that a conflict among the circuits is a situation where review by this Court will be considered.

Respondents argue, however, that eventually the litigation spawned by the adoption and rescission of Rule 15c2-2 will cease. As a practical matter, however, if this Court does not resolve the conflict among the circuits and refuses to grant Petitioner's writ in this case then more not less litigation will result in the future. Brokerage houses will advance the Fourth Circuit rule, and customers will continue to advance the rule established in the five other circuits.[1]

If this Court desires to hasten the eventual demise of Rule 15c2-2 litigation then it should summarily reverse the Fourth Circuit in this case so that there will be no conflict among the circuits. Reversal of the Fourth Circuit by this

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1. In fact, the Fourth Circuit's decision in *Clark* has already become a factor in similar litigation involving what effect the repeal of SEC Rule 15c2-2 should have on contracts with "exclusionary language." The Fourth Circuit, in the unpublished disposition of *Emery* v. *Legg Mason Wood Walker, Inc.*, No. 90-2693 (4th Cir. June 3, 1991) (WESTLAW, CTA4 database), directly cited as authority its holding in *Clark* while interpreting the exclusionary language involved as mere notice and reversing the district court's refusal to compel arbitration of the customer's federal securities law claims.

The federal district courts in *McCausland* v. *A.G. Edwards & Sons, Inc.*, 1991 Fed. Sec. L. Rep. (CCH) ¶95,899 (W.D. Pa. Mar. 7, 1991) and *Brand* v. *Piper Jaffray & Hopwood, Inc.*, 756 F.Supp. 405 (D. Minn. 1991) cited *Clark* as contrary authority to their decisions which, on the basis of the exclusionary language at issue, denied the brokers' motions to compel arbitration of the federal securities law claims.

Court will indeed make the application of Rule 15c2-2 a "thing of the past." Failure to correct the Fourth Circuit decision will only generate further litigation on the issue.

This case also presents an opportunity to examine an important issue of administrative law: is a regulated entity bound by provisions of a contract which the entity itself inserted in response to a regulatory directive once the directive is rescinded? Five circuits have held that the regulated entity cannot disavow such provisions. The Fourth Circuit decision in this case, if permitted to stand, will invite the argument that certain contractual obligations can be avoided whenever regulations change in the future. The uncertainty created by the ability to disavow contractual provisions should be avoided where possible.

2. *The Applicable Language in This Case Clearly Excludes Federal Securities Law Claims from Arbitration.*

Merrill Lynch argues that the "exclusionary language" which it used in its agreements with Petitioner does not exclude federal securities law claims from arbitration. As shown in a footnote on page 12 of the brief in opposition, Merrill Lynch has already lost this argument before the Eleventh Circuit.

In *Blue Gray Corps. I & II* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 921 F.2d 267 (11th Cir. 1991), virtually identical language to that contained in three of the four applicable agreements in this case was before the court. As here, Merrill Lynch argued that its own language was ambiguous and, given the presumption in favor of arbitration, the language should be construed as requiring arbitration of federal securities law claims. The Eleventh Circuit disagreed:

> The arbitration clause in this case did more than merely notify the plaintiff of the existing state of the law; it expressed the agreement between the parties . . . The parties agreed to arbitrate controversies "[e]xcept to the extent that controversies involving claims arising under Federal securities laws may be litigated." The

> district court found the plain meaning of the clause to provide plaintiff with the option to bring federal securities claims in court. Defendant would have us, in essence, read the word "may" to mean "must." We find no reason to change the plain meaning of the language. Defendant presumably was capable of drafting this agreement in a way so that plaintiff's federal securities claims would now be arbitrable under current law. [fn 4] Even in light of the presumption in favor of arbitration, and the strong temptation to rewrite the arbitration agreement to achieve that result, we recognize that the presumption does not require parties to arbitrate when they have not agreed to do so.
>
> * * *
>
> 4/E.g., "Except to the extent that controversies involving claims arising under Federal securities laws are not arbitrable under applicable securities laws . . ."

Blue Gray Corps. I & II, 921 F.2d at 271.

Merrill Lynch would also have this Court misapply the presumption in favor of arbitration. The point here is that the language at issue *excluded* federal securities law claims from the scope of the agreement between the parties to arbitrate. "[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute." *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985). More recently, this Court has held that ". . . we have recognized that the FAA [Federal Arbitration Act] does not require parties to arbitrate when they have not agreed to do so . . . (the Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement . . ." *Volt Info. Sciences* v. *Stanford Univ.*, 489 U.S. 468, 478 (1989).

Since the purpose of Rule 15c2-2 was to exclude claims under the 1934 Act as well as claims under the 1933 Act from arbitration, it ill behooves Merrill Lynch at this late date to argue that even though the subject language was inserted by

Merrill Lynch in response to the SEC rule, the language did not accomplish the purpose of the rule.

Finally, Merrill Lynch conveniently ignores the language contained in one of the four applicable agreements. Specifically, the Managed Options Agreement signed by the parties on June 24, 1985 reads as follows:

> Although you have signed a customer agreement form with MERRILL LYNCH that states you are required to arbitrate any future dispute or controversy that may arise between us, you are not required to arbitrate any dispute or controversy that arises under the federal securities laws but instead can resolve any dispute or controversy through litigation in the courts.

In order to avoid this clear statement and evidence of the intent of the parties not to include federal securities law claims within the agreement to arbitrate, Merrill Lynch makes a tortured argument based in part on reasoning contained in the district court opinion ordering litigation of securities claims. Admittedly, that order was not contested by Petitioner. Presumably, Merrill Lynch would have Petitioner contest and appeal a district court ruling in its favor. Throughout this litigation, Petitioner has consistently maintained that he was entitled to litigate his federal securities law claims with Merrill Lynch. The argument by Respondents concerning construction of the litigation language is misplaced and without merit.

CONCLUSION

Respondents admit in their brief in opposition that a conflict exists among the circuits on the issue presented in this case. Under the authority of five circuits, Mr. Clark would be permitted to litigate his federal securities law claims. The Fourth Circuit has denied Mr. Clark this right. In so doing the Fourth Circuit has without good reason placed itself in direct conflict with the other circuits.

Petitioner respectfully requests summary reversal of the Fourth Circuit decision based upon the petition, the brief in opposition and this reply brief. By making the law of the land uniform on this issue, future litigation concerning Rule 15c2-2 will subside.

Respectfully submitted,

DAVID KENT HIGGINS

Counsel of Record for Petitioner

E. GLENN ROBINSON
ROBINSON & MCELWEE
P.O. Box 1791
Charleston, West Virginia 25326
(304) 344-5800